



VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

CALIFORNIA RETAILERS ASSOCIATION



July 30, 2012

To: Members of the Assembly Appropriations Committee

From:

- Allstate Insurance Company
- American Council of Engineering Companies of California
- American Council of Life Insurers
- Association of California Life and Health Insurance Companies
- California Association of Health Underwriters
- California Chamber of Commerce
- California Farm Bureau Federation
- California Framing Contractor's Association
- California Grocers Association
- California Independent Grocers Association
- California Manufacturers and Technology Association
- California Restaurant Association
- California Retailers Association
- California Taxpayers Association
- Financial Planning Association
- Financial Services Institute
- Insurance Brokers and Agents of the West
- Investment Company Institute
- National Association of Insurance and Financial Advisors of California
- National Federation of Independent Business
- Pacific Life Insurance Company
- Personal Insurance Federation of California
- Plumbing-Heating-Cooling Contractors Association of California
- Principal Financial Group
- Securities Industry and Financial Markets Association
- Small Business California
- State Farm
- The Financial Services Roundtable
- Western Electrical Contractors Association

RE: Opposition to SB 1234, AS AMENDED June 27, 2012

The 29 organizations listed above are writing to express our strong opposition to SB 1234. This legislation creates a state-run retirement savings plan for private sector workers and guarantees a set rate of return on investment. It mandates employers with five or more employees to automatically enroll their workers into the state-run plan unless

a retirement savings option is already available at the workplace. Employers that do not comply would be subject to a penalty of \$250 per employee.

While we applaud Senator De Leon for encouraging Californians to save for retirement, we believe that SB 1234 is a major step in the wrong direction. The state is already facing a massive unfunded pension liability for its public sector workers. In our view, this is simply not the time for the state to create and assume liability for any new plan for private sector employees, much less one which guarantees a set rate of return on investment.

In addition, the employer mandate in SB 1234 is highly problematic. Such a mandate is counter to purported efforts to make the state more business friendly. Employers in general and small employers in particular want and need the flexibility to offer the mix of compensation and benefits that best meets the needs of their employees. Requiring employers to offer a benefit that their employees may not value is not an effective use of these employers' time and resources. While employees may, for example, prefer different benefits or additional compensation, employers would be forced to offer this benefit, possibly at the expense of others, or face a sizeable penalty.

Moreover, we are concerned about the operational questions, compliance costs and liability issues the legislation raises. Recent DOL advisory opinions suggest we have good reason to be concerned. The attached July 16 legal memorandum prepared by Michael Hadley of Davis & Harman LLP on the "Application of ERISA to SB 1234" states that "if the DOL or a court were to apply the reasoning in recent analogous DOL advisory opinions, then the California arrangement would (a) not meet the requirement to be a "governmental plan" exempt from ERISA; (b) create *separate* ERISA-governed plans, each of which is separately subject to ERISA's reporting and disclosure requirements; and (c) impose ERISA's fiduciary provisions on the private employers that participate in the arrangement." Mr. Hadley further concludes that SB 1234's June 27 amendments do not change the analysis. He states, "These conclusions would not change simply because the contributions under the arrangement are made to individual retirement accounts rather than a qualified trust because the California arrangement includes an automatic enrollment feature that would prevent it from meeting DOL's safe harbor for payroll deduction IRAs."

This would mean that each private sector employer would be burdened with the cost of compliance and administration. Such costs would include reporting requirements – such as the filing of Form 5500, an annual actuarial demonstration that the program satisfies minimum funding standards, liability for underfunding under the ERISA rules, and responsibility for actuarial violations. The estimated actuarial valuation alone would likely cost each employer somewhere between \$2,000 and \$5,000 annually. Pension Benefit Guarantee Corporation (PBGC) premiums, which are scheduled to increase from \$35 per person to \$42 per person in 2014 and \$49 per person in 2014, would also be required; if these premium costs are not subsidized by the government, then they would have to be paid for by the employer. Finally, each individual employer would be subject to fiduciary liability.

While SB 1234 is concerning to the business community, it should raise red flags for the state as well. By creating a plan for private sector workers, the legislation would expose the state to new and substantial ERISA and IRS liability even if the intent of the bill is to be exempt. For example, under ERISA, the state would also have a fiduciary duty to the plan participants. Among other things, it would need to ensure that the plan is properly managed, that plan options are appropriate and adjusted as necessary, and that plan expenses are reasonable. Plan participants could bring actions against the state if they believed the state was not meeting its obligations. In addition, the state would be liable for the breaches of other fiduciaries, and state employees making plan investment and management decisions could be held personally liable. While fiduciary insurance may help reduce state out-of-pocket payments for breaches or other violations, it does not eliminate the state's or individuals' ultimate responsibility or liability. Furthermore, to limit liability exposure, the state would have to undertake substantial compliance monitoring to ensure that no prohibited transactions occur, that non-discrimination testing is done correctly, and that the necessary ERISA and IRS forms and filings are properly executed.

In addition, the state would be incurring huge annual costs to provide this service. The attached recently released white paper by Richard Wright, a consulting actuary with Milliman in San Francisco, concludes the administrative costs of the program will be substantial. If all eligible employers and employees were to participate in the program, the annual administrative costs are estimated to be \$775,000,000 or more.

Liability and cost are significant considerations the state should take into account. While the bill sets aside one percent (1%) of the total program fund to administer the program trust, \$775 million dollars far exceeds the 1% cap. The administrative costs to run this program will more than likely surpass 11% of estimated annual contributions. Now is not the time for the state to assume this cost.

Finally, the effort, liability and expense of SB 1234 are unnecessary given that California already has a robust and highly competitive retirement savings market. California financial services firms - which directly employ 536,000 workers in the state and indirectly employ countless others - currently offer a wide variety of cost effective retirement savings alternatives. SB 1234 would create a new state-run structure that would directly compete for business with a wide range of California financial services firms and retirement plan providers. This would directly affect the

livelihoods of securities firms and individual brokers, insurance and life insurance companies and individual agents, plan providers and their employees, and others in the financial services industry at a time when the state's unemployment rate is 11%.

For these reasons, we must oppose SB 1234. We appreciate the opportunity to provide input on this legislation.

Cc: Senator De Leon

Attachments: Davis & Harman Memorandum  
Milliman White Paper